

## FARM SECTOR OUTLOOK: MANAGEMENT RESPONSE

## GRAINS

The '88 drought dramatically changed the lackluster "loan rate pricing" and "government program participation" outlook for corn and soybeans of six months ago to an exciting market that wonders if there will be enough grain to get through until '89 crops are harvested. The best minds in the market are now suggesting that prices have risen enough to ration supply adequately and that corn and soybeans will average in the neighborhood of \$2.50 and \$8.00 per bushel, respectively, for the 88/89 marketing season. This, of course, is all predicated on normal crops in the rest of the world in 1989. A major disruption in supply in either direction will mean all bets are off. The current situation brings a number of management decisions to the forefront.

Store or Sell?

Conventional wisdom suggests that storage doesn't pay in short crop years. If, however, the decision is made to store, recognize that grain can be stored priced or unpriced and that the factors in this decision are not the same. Storing priced grain depends on the relationship between today's cash price and the deferred delivery price contracted for. The current market is unwilling to pay storage costs. Negative returns to storage strongly suggest not storing priced grain. Storing unpriced corn and beans is speculation, pure and simple. Holding corn on the farm for only 3 months can cost as much as 25¢ per bushel in added variable cost (shrink, extra drying, movement, aeration, interest, and quality deterioration). Costs would even be greater, as much as 45¢ per bushel, for soybeans, given the higher price and foregone interest. The upshot of this discussion confirms conventional wisdom -- sell now. Selling will insure a profit, storing priced crops is a loser, and storing unpriced crops can turn a winner into a loser.

'89 Crop

Despite the fact that there are a lot of unknowns relative to next year's crop, current prices elicit considerable discussion about the wisdom of pricing some of the '89 crop now. Expectations, again given normal production here and abroad, are that the 89/90 corn price will average slightly above the loan rate. Current '89 harvest delivery contracts exceed the loan rate by as much as 75¢ per bushel. Capturing this extra income, at least on some of the '89 corn, can't lose money. Adding only 50¢ to the '89 target of \$2.84 results in a realizable price for corn above \$3.25, a price that will generate a profit. Soybeans are somewhat more questionable. However, with the expectations of increased acres here and abroad, \$6.00 for '89 beans is not outside the realm of possibility. The added \$1 per bushel offered by current forward contracts is tempting to some managers and should be considered by others.

Government Program

The 1989 corn program requires a 10 percent acreage reduction with no paid land diversion. The '89 corn loan rate, target price, and maximum

deficiency payment have been set at \$1.65, \$2.84, and \$1.19, respectively. Current market prices are prompting some producers to question if they should participate in the corn program next year. They wonder if they should plant all their corn base, and some wonder if they should plant corn on what would normally be soybean acres. The evidence suggests that both actions would be mistakes. A producer can expect, with a high degree of certainty, that '89 corn can be sold at harvest for something greater than \$2.70 per bushel before it would be profitable not to participate in the program. Likewise, planting corn on bean ground puts a producer outside the program and is likely to reduce net income per acre, given the probability that '89 beans will be priced in the \$7 range. Producers may, however, want to consider planting beans on some of their permitted corn acres (10 to 25 percent as allowed and yet to be determined by the Secretary).

#### MACHINERY

The drought has ~~also~~ revised producers' thinking relative to equipment replacement. After a long dry spell, machinery dealers were smiling again--at least until June, when farmers stopped replacing equipment, combines, and tractors. Purchases are likely to pick up during the winter and spring but will not be as robust as dealers would prefer. Producers have prudently delayed replacing "large ticket" items.

Farmers with debt outstanding will find that most of their questionable equipment can be repaired at reasonable cost and that any excess cash will probably be better utilized to reduce debt rather than trade up for new equipment. There will, however, be equipment that will require replacement rather than repair. Producers need to exercise their best judgement and put their mechanical skills to work when making the repair/replace decision. Taking on more debt when the future is clouded can create more problems than it solves. Good used equipment is becoming more difficult to find as the on-farm inventory gets older and fewer farm businesses liquidate. If, however, the opportunity presents itself, replacing aged and worn equipment with excellent/good used items will likely prove to be a good move.

#### LAND

The immediate past (1988) and the short and longer run outlook complicate land rental and purchase decisions. The lingering memory of crop losses in 1988 will temper the recent upturn in land rents and prices. The near term price outlook will, on the other hand, encourage some producers to bid higher rents and prices, as will the lower acreage reduction requirement for 1989. Higher input costs (seed, chemicals, and fertilizer) and lower target prices will tend to lower prices and rents. The longer run picture for expanding world production, lower loans, lower target prices, and lower market prices will likely stabilize farmland prices, if not cause a further reduction. The question is ... What to do?

Let's start with the purchase. Don't buy if it isn't necessary. Most of the returns from land go to operators rather than owners. Conversely, buy only if you have to and then only if you can do so mostly with cash. If you do buy, plan to have a minimum of 1/3 down. Fifty percent (1/2) would be better and would leave you in a more secure position to weather any economic storms in the near future. This year's drought will encourage operators to desire a change from cash rent to share-crop rental agreements. Landlords, on the other hand, will desire the opposite. If cash rental is the only option, producers must be clear in their minds what they can afford to pay. That means--don't get caught in a "bidding contest" with the neighbor, don't forget fixed costs, and don't work for zero wages. A reasonable cash rent for 120-bushel corn ground, allowing for a reasonable return for labor, equipment, and management, is likely in the \$75-per-acre range for 1989. Paying more than this means some of the above inputs are not earning what is due.